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Understanding the Role of Bank Relationships, Relationship Marketing, and Organizational Learning in the Performance of People's Credit Bank

Sunarto, H.

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Chapter 10
CONCLUSION, LIMITATIONS, AND IMPLICATIONS

10.1 Introduction

In the imperfect financial market, banks and clients have been complaining since credit allocation is not optimal. It happens, among other reasons, because of the presence of asymmetric information. From the perspective of bank relationship studies, having a strong bank-client relationship is believed to be able to partly overcome this problem. A bank relationship study puts more focus on value creation accrued to borrowers. However, Ongena and Smith (2000) state researchers need to better understand the impact of bank relationships on bank performance. The idea of Ongena and Smith inspire us as a point of departure for this research.

Moreover, in the increasingly competitive financial market, bank management needs to establish a competitive strategy to prevent client exit to a competing bank through a relationship marketing concept. Besides that, organizational learning also plays an important role in organization knowledge renewal by managing tacit information, which potentially creates asymmetric information that enables an organization to find new ways to survive and succeed in new situations.

In addition to Ongena and Smith's idea, there are separate studies that examine the impact of relationship marketing (e.g., Payne, 2000) and organizational leaning (e.g., Sadler-Smith, 2001) on firm performance. There is a lack of studies on integrating bank-client relationships, relationship marketing, and organizational learning in explaining firm performance, especially bank (BPR) performance. This study addresses this gap using empirical research through a cross-fertilization of these three concepts in explaining bank performance. In order to answer the last three research questions, the main concepts above have been translated into two models: (a) the bank performance model and (b) the client intention to leave model.

The goal of this research is not only to simply find support for the hypothesized models but also to establish ways to improve bank performance by building a strategic weapon from all relational variables of the three main concepts (or constructs). From the theoretical and empirical reviews, it has been shown the cross-fertilization was based on the common characteristics of the three main concepts (constructs) in explaining bank performance, such as duration of the relationship,

value creation, and flow of information during the period a bank and clients make relationship exchanges. In other words, bank relationship studies are simultaneously concerned with (1) reducing asymmetric information, (2) increasing the bank's confidence level in making loan decisions, (3) minimizing the bank's expected loan losses (risks), and (4) finally, achieving a better allocation of loans. Relationship marketing studies see that at any point in time along the duration of a bank-client relationship, a bank faces two possible states of occurrences: good clients can either exit or stay. Strategically, retaining clients is more efficient than acquiring new ones. Taking into account that organizations learn through individuals acting as agents for them, BPR directors have to utilize tacit information (knowledge) of individual loan officers to achieve better bank performance. Organizational learning is the process of improving actions through better knowledge and understanding (Fiol and Lyles, 1985).

Since relationship dynamics is a complex process, Chapter 9 has paid special attention to this matter to get inside and uncover the black box of relationships. To know more about how the relationships among parties work, three frameworks of analysis have been adopted: (1) the value chain of a social network and personal relationships of many transactions, (2) principal-agency relationships, and (3) social and location-dependent relationships.

The following sub sections explain some research findings presented under the headings of overall conclusion, limitations, and implications.

10.2 Overall conclusion

There is no doubt that long-term relationships are extremely important for both clients and BPRs. This does not suggest that acquiring new clients should be disregarded. This research supports the mainstream marketing principle that most successful business firms employ offensive as well as defensive marketing strategies. The objective of the offense strategies is to generate new customers; the objective of the defensive strategies is to keep current customers (Fornell and Wernerfelt, 1988). These research findings disclose that BPR managers unanimously accept long-term relationship principles as a strategic intent.

Despite being accepted unanimously, this strategic intent does not firmly show how to implement some basic instruments of relationship marketing, such as

monitoring a client's intention to leave to prevent clients from switching to competing banks. The number of drop out clients that no longer need credit is relatively high. Regardless, BPR directors believe that clients may reestablish their relationships at some point in the future. The existence of a gap between intention and action may be one reason why relationship marketing does not have a significant impact on BPR performance.

Besides that, BPR may not be able to articulate or implement an idealized organizational learning as well, despite the abundance of theoretical and empirical studies that have been conducted on the majority of commercial banks in developed countries. It is true that these studies contribute a valuable systematic frame of thinking. This could be the reason why organizational learning does not contribute significantly to relationship marketing. BPRs do learn from experience albeit their learning mode stays in an incremental mode (Miner and Mezias, 1996) or at a low level of learning rather than a high level **(**Sadler-Smith et al., 2001**).** Every organization is a learning organization, including BPRs. The organizational learning of BPRs suffers from the high turnover rate of AOs and directors, the lack of an information sharing mechanism, too much emphasis placed on banking techniques for human development, the underutilization of the relationship as a company asset, and the inability of a firm to acquire knowledge and transform it into a real competitive weapon, such as by reducing transaction costs while speeding up loan decisions.

However, bank relationships do contribute to organizational learning and relationship marketing. One important finding in this research that differs slightly from the existing bank relationship studies is about sources of value that accrue for clients. The sources of value in a relationship likely do not come so much from lower loan interest rates, long tenure (loan duration), and less pledge collateral but rather from progressive lending (availability and higher principal), speedy loan disbursement, and the ease in negotiating during client financial distress. Regulations say that changes in the terms of conditions may affect or increase the NPL, resulting in penalties for BPRs, which will potentially reduce their healthiness. However, BPRs do provide benefits to those clients who have long and good relationships with BPRs from selected terms and conditions that are free from punishment. This may be one of the inhibiting factors of relationship value creation to clients offered by BPRs, which are regulations of prudential banking practices. Repeat loans are one of the long term bank client relationship characteristics that should be driven by the value of their

close ties. However, only a small percentage of clients gain value from lower interest rates, longer tenure, and lower collateral requirements and flexible loan installments. Bigger portions of clients benefit from progressive lending policies, speedy credit delivery, and easier negotiations during clients' hard times. The latter do not match with most BPR claims, in which they claim speedy delivery, easier negotiations, and progressive lending are prominent BPR strategies to embrace clients. Most importantly, both parties remain in close relationships where there are some possibilities to make necessary corrections of an inconvenient relationship, which can result in more benefits for both parties.

Within the context of the bank relationship concept, most BPRs ration credit to clients who are inclined to overstate their loan proposals. Time constraints in executing speedy delivery and a lack of available information from new clients is a driving force to engage in credit rationing. From BPR's point of view and that of a secure lending perspective, credit rationing, having a compulsory savings account and collateral are considered as layers of protection against credit risk, regardless of whether the client is aware of it or not. Between the starting and the most recent bank-client relationships, credit rationing has decreased from 55% to 12% for clients.

Repeat borrowers have better track records of their businesses kept in BPR's files. This allows BPRs to reduce asymmetric information that eventually increases BPR confidence and increases discriminating power to distinguish between creditworthy and non-creditworthy clients. This leads BPRs to make a revised misclassification error where there is a migration of some rationed to non-rationed clients or vice versa. Repeat borrowers learn not to apply for more credit than they actually need. According to clients, compulsory savings accounts are present in all types of BPRs but in a lower proportion than voluntary savings accounts, except in sharia BPRs. Collateral mostly (around 70%) consists of land title certificates and car and motorcycle ownership certificates.

The weak impact of a bank's relationship on organizational learning and relationship marketing is also driven by underutilized monitoring mechanisms. The monitoring stage has two dimensions: (a) collecting loan repayments and (b) collecting updated information to act as an early warning sign in detecting client risk and to anticipate repeat loans in the future. Obviously, the AOs devote their time for repayment collections, spending 2 to 3 times more in resources on delinquent clients than on good ones. The second dimension cannot easily be interpreted, since the

information collected and transformed into company knowledge to improve the decision process of the credit cycle involves complex elements.

Another finding is about group versus individual lending. Although the worldwide accepted joint liability system of the micro or small credit market has been a “trademark” of Grameen Bank in Bangladesh recently, it was actually introduced in Indonesia by De Wolff in the early 1900s to MFIs in Indonesia (Steinwad, 2001). However, the small number of BPRs providing group lending and small amounts of outstanding credit for group lending implies that BPRs tend to favor individual lending rather than group lending. Group lending methods used to solve the adverse selection and moral hazard problems in the financial market with asymmetric information (Varian 1990, Stiglitz 1990, and Ghatak 1999) may not be seen as promising business by BPRs.

The duration of the relationships between BPRs and their clients display some important phenomena. The average starting point of the bank-client relationship was in 1996; the earliest was in 1982, and the most recent was in 2002 through a credit contract rather than deposit. It does not automatically verify the existence of “credit hungry” clients. Clients will try to minimize their risks of losing money from their deposits that they entrust to BPRs by first checking on the reputation of BPR before they begin their relationship.

During the development of the relationship, most clients (around 80%) have exclusive relationships with one incumbent BPR only. There is a strong correlation and statistical significance between exclusiveness and intention to leave, where the higher the exclusiveness the lower the intention to leave the relationship. This may signal that clients have limited sources of external funds, lower bargaining power with BPRs, and higher switching costs. During the 6.7 year average duration of the relationship, clients received an average of 5.2 repeat loans or loan renewals on almost a yearly basis. The monitoring stage plays an important role in loan renewal, especially about the opportunities of BPRs to reduce asymmetric information problems and to improve credit granting of repeat loans accordingly. Most loan officers visit clients either at their homes or business sites, with a mixed approach of formal and informal visits for either information gathering or repayment collection. A loan officer is replaced two or three times during the course of a relationship.

Some businesses have non contractual relationships with customers, while in the credit market in general and particularly in BPR, a loan relationship is based on a

contractual basis. Either clients or BPRs can actively initiate their relationships. It seems a bigger proportion of clients in the sample initiated the relationship due to the closer distance between the client's business site and the BPR location. However, it does not necessarily eliminate the uniqueness of the direct marketing approaches used by BPR through a loan officer by going up to the doorsteps of the clients, especially during the monitoring stage. After a client's business has been in operation for a number of years (on average 7 years), the client or the BPR will initiate a relationship. This time lag between the year of establishment and the beginning of the relationship is the start up period and perceived as a risky period for the client's business with a high probability of failure. However, some BPRs may apply practical guidance when a relationship starts after a client's business has been in operation for at least two years. Hence, clients who are lucky enough can sign a loan contract earlier than the 7 year time lag.

The duration analysis considers the life cycle of a bank-client relationship. It is about survival and switching mainly in bank relationship studies and about acquiring and retaining customers in relationship marketing. The durability of a relationship is very important for business. A durable relationship is a long-term relationship between a bank and good clients that creates benefits for both parties and stakeholders at large. The durability of a relationship is a function of (a) the relationship value along with a decrease in asymmetric informational problems, (b) exogenous factors that affect the fragility or stability of BPR, among others, arising from competition and external shocks such as a crisis that threatens the continuation of credit availability, and losing clients who switch to a competitor, and (c) how a company can improve by adapting external changes through learning processes.

Threats to the durability of a relationship that arise from external factors such as economic shock and heavy competition do exist. During the peak of the 1998 economic crisis, most clients felt that there was no credit tightening, with less volatile interest rates than those in commercial banks. It looked like a loan smoothing policy to help clients intentionally. However, it may simply be that BPRs have not applied floating interest rates for a given contract as opposed to commercial banks that have applied floating interest rates for borrowers since the first episode of the financial crisis in 1991. BPR may adjust interest rates for newly signed contracts for either new clients or repeat borrowers. Clients consider a decline in market demand of their businesses to have a bigger impact on their businesses rather than a lack of credit.

In 2003, there was a mixed perception among BPRs concerning the threat of competition, especially from some commercial banks entering a segment within BPR's domain. Those BPRs that operate in urban areas tend to see a real threat from these commercial banks, while those BPRs that operate in rural areas do not. The outcry from the BPR association, Perbarindo, about the threat of clients switching to these commercial banks has been increasing recently. This most recent situation as seen by Perbarindo could modify the perception of BPRs, as an increase in competition could be underway. Cooperation between BPRs and commercial banks under the linkage program scheme cannot lessen the tension of competition. BRI units and BPD branches are the heaviest and closest competitors of BPRs, in which they have employed different strategic tools. The first two banks have better pricing advantages and lower interest rates as strategic tools to maintain their relationships with their clients, while BPRs are able to offer timely credit decisions and provide progressive lending incentives to clients. Each of them has their own clientele segments. However, there are always some intersecting areas where to some degree BRI Units and BPDs can imitate BPRs' strategies or vice versa. They have been operating in the same market together for a long period where mutual understanding has been built among them and, therefore, there is less tension among them in serving the same market segment.

Switching and returning clients do exist in bank-client relationships. Roughly 18% of the clients have switching experience and rejoin the relationship to incumbent BPRs. They are client rejoinders. Some clients should exit permanently regardless of what their reasons are. Nevertheless, there is not any data or studies about the magnitude of client exit. The clients also have a low (about 16%) intention to leave the relationship. However, there is a statistically low insignificant correlation between switching experience and an intention to leave a relationship. From a relationship marketing point of view, a high retention rate is one of the successful measures in maintaining long-term relationships with high-grade quality clients. The clients tend to be satisfied with BPR services and a lack of competitor intensity to lure clients may induce both to have low intentions to leave a relationship and emerging client rejoinders. By seeing these facts, the lack of effort undertaken by loan officers to prevent switching can be justified.

Last but not least, the most important part of the findings is in relation to geographical aspects, especially about geographic dimensions: social and location-

dependent relationships. Geographical or location elements of BPR have been presented throughout Chapters 1 to 9 with different areas of focus. At least the research findings can partly answer why geographical space has a special importance for BPR sustainability.

BPR is characterized as a small bank, unit bank, local bank, and community bank. BPR as a community, unit, and local bank depends heavily on the developmental progress of its surrounding area. It employs opportunities through the deployment of its resources to support the mobility of loan officers to go to client doorsteps as far away as possible from the BPR office. There is a significant correlation between motorbikes used by AOs and their coverage area. The closeness of clients in their relationship with a BPR depends upon the geographical distance and social relationships with mostly the BOD and loan officers. Therefore, a BPR as an MFI has uniqueness in terms of social and location-dependent relationships to achieve a high and sustainable performance.

A BPR cannot diversify its loan portfolio geographically, as is done by BRI through nationwide investments in BRI units. Even so, surprisingly BPR could retain intermediary function amid the heavy financial crisis. The stability of its intermediary function is most likely supported by the ability of BPR to maintain close relationships with the clients of both borrowers and depositors. The concept of "survival of the fittest" motivates BPR to keep interest rates relatively stable compared with commercial bank interest rates as demonstrated by inter-temporal differences during the crisis and in its aftermath. There was only a minor threat to the durability of the BPR-client relationship during the financial crisis, in which a disruption in the supply of credit was almost non-existent.

Within the framework of a value chain, external shocks have disrupted the funding side of BPRs and, in turn, the availability of loans. It is likely that urban BPRs and BPRs in district towns with urban depositors are hurt more by deposit withdrawals than BPRs in district towns with local depositors. Depositors from the city have more alternative means of investment and are able to divert their deposits in BPR to commercial banks that offer higher interest rates and lower risks. Moreover, sections 9.2 through 9.4 reveal a spectrum of relationship dynamics and their complexity among channel members. Each member of a channel has its own role to contribute to the value of a relationship exchange. However, there are possible

disruptions in a long-term relationship both upwards and downwards that may emerge from increasing spatial competition and external shocks, both nationally and locally.

Furthermore, within the framework of a principal-agency relationship there is a way of viewing the pattern of a relationship involving delegation of authority and monitoring. By using this framework, the common view between a bank and its clients should be seen as a series of relationships: (a) between a manager and loan officers, (b) between loan officers and clients directly, and/or (c) between loan officers and clients indirectly through an independent channel. In such a way, the researcher can see more vividly, for example, about the potential bottleneck in the flow of tacit information and pinpoint the weaknesses or advantages of a certain member of a value chain. This view will enrich the simplified relationships in previous bank-client relationships and relationship marketing, in which relationships occur between a bank and its clients directly. The relationships among members of a value chain relationship within a principal-agent framework disclose complexities in relationships as a process.

The social and location-dependent relationship research discloses some points that show BPRs have real differences with commercial banks. It is concerned with spatial competition, growth strategies, and ultimately BPR survival. Unfortunately, the geographic boundaries of a BPR's operational area is not in line with its administrative region but the regulatory body, Bank Indonesia, which still imposes restrictions (regulations) based merely on its administrative boundaries. As a local bank, a BPR will maintain its clients through social and location-dependent relationships and utilize most of pre-existing relationship of a prospective new clients. A BPR director can accommodate any information for a more vigilant evaluation of clients from any region, including those who are from a "black list" area, to avoid classifying potentially good applicants as non-creditworthy.

10.3 Limitations

Several limitations emerged because of some natural and academic or methodological constraints of the research undertaken. First, the general issue of microfinance data that should be readily available to researchers has not been resolved because there is no single authorized coordinating institution to oversee it. Second, this study was drawn from a moderately-sized sample of approximately 150 BPRs and

140 clients. This is one issue of an SEM analysis with a Likert-type scale of construct measurements that require a larger sample size. Third, this research encountered a low impact of organizational learning and relationship marketing on bank performance. Although some possible reasons have been explained, this research is unable to precisely detect the source of the problem due to a lack of data and possibly misspecifications of the model because of some mediating factors being omitted. Fourth, the number of cases is sufficient but the in-depth studies may be less rigorous. This may raise the issue of the generalization of the findings of relationship as a process. However, it sheds light on the relationship issue as a complex undertaking in financial market business.

10.4 Implications and further research extensions

Managerial implications

Worldwide development in bank relationships, relationship marketing, and organizational learning disciplines with a rigorous empirical and theoretical basis have reached advanced levels. They will still evolve in the future. However, there is no reason to entirely discard the prevailing practices of BPR, such as in retrieving soft information directly from the AOs' memory, which is preferred to having BPR install costly and sophisticated tailor-made informational processing software. Bank Indonesia and PT. Permodalan Nasional Madani (PNM) have recently promoted advanced information processing technology. It is good for surveillance implementation. However, in considering BPR's condition, they should take into account gradual steps in adapting technology and educating BPRs to use information optimally to improve their competitiveness.

From BPR's view, this study is concerned with what is called a defensive marketing strategy (Fornel and Wernerfel 1987, 1988) in the sense that the underlying intent of BPR's competition is to emphasize that marketing resources may be better spent in keeping existing customers than by attracting new ones. This study also provides some lessons to learn. Client satisfaction is necessary to increase the retention rate, but according to Gale (1997) satisfaction is not enough. BPR's board of directors has to respond proactively to clients and listen to client concerns to overcome the gaps between their expectations and the real actions taken by loan officers. The loan officers who stay on the frontline may not be able to take corrective action. Within a dynamic environment, the BPR strategy may become obsolete, which

can reduce client satisfaction. Moreover, Gale (1997) shares his experience that retail banks with higher retention rates perform better than branches with lower retention rates. Customer retention rates and attraction rates are driven by the customers' perception of what a particular bank offers relative to its competitors.

This experience may alert the BPR director to proactively revise preventive actions in order to focus on client satisfaction positively. Increasing competition is real and offensive strategies from commercial banks, such as Bank Danamon with the *Danamon Simpan Pinjan*: DSP (Danamon Savings and Loan), increase tension in the microfinance market. Commercial banks have competitive advantages in terms of: (a) fund mobilization, (b) personnel quality, (c) technological advancements, and (d) geographical network. One thing that BPR can do to remain competitive is through the defensive strategies mentioned above. This could be a promising shield for BPR to remain in the market and grow with the progress of their clients. The need to cater to specific customers rather than all possible customers should be a more important policy for BPR. More specifically, the managerial implications of this analysis are a signal for BPR to look forward so the board of directors can take necessary actions, among others:

First, they can redefine job descriptions, especially related to the scope and/or depth of loan officer tasks. For example, in Chapter 6 it was revealed that during the monitoring stage, loan officers emphasize repayment collections. In this case, the director can assign them additional tasks to pay more attention to information gathering. By doing so, they can start sorting borrowers into two categories – promising (creditworthy) and unpromising (credit unworthy) in such a way that BPR can anticipate potential valuable clients.

Second, they can improve the organizational learning – not only learning by doing but also learning by planning. Unconsciously, loan officers accumulate enormous tacit information from field visits. Without a regular and systematic mechanism of information codification and sharing for organizational improvements, this information will disappear. Learning by planning means BPR should take advantage of this information to anticipate future external changes (competitors' moves, mounting client dissatisfaction, etc.). This action is a corrective measure toward the weaknesses of BPR in information codification and counterproductive in preventive measures toward client satisfaction. In addition to this, BPR can initiate complaint handling promptly to increase service quality. Practically, it reinforces speedy delivery in loan disbursements with an increasing degree of confidence, since the manager receives more up-to-date and accurate field information.

Third, they can revise the meaning of a “doorstep” or proactive approach, which is not merely the manifestation of a loan officer’s onsite client visit, as it also provides more substance to the visit. The reasons for this approach are not only for onsite repayment collection to reduce borrower transaction costs but also to use frequent face-to-face contact to build trust and understanding between loan officers and clients. It facilitates the flow of private information from clients to BPR through loan officers. However, it is not an easy task because it entails specific skills in service excellence, time allocation, and span of control loan officers have over their clients. This is a managerial problem where competitive pressures force BPR to be more creative to survive. In other words, this gives another meaning to the doorstep approach in turning information collection from being byproduct of monitoring to a main product comparable to repayment collection. The main outcome of monitoring is not only repayment collection but also information collection.

The underlying assumption of the linkage program is that BPR is in a position where they lack funds, whereas actually macro financial data shows otherwise. Many BPRs in the survey do not need such linkage programs or have difficulties to meet the requirements, especially those subsidized credit programs where most of the BPRs are in favor of low fund costs. Naturally, most BPRs have to open deposits (a) for liquidity smoothing and (b) to facilitate the transfer mechanism for inter-bank transactions and to receive fund transfers from client loan repayments. Both policymakers (the Ministry of Finance, Bank Indonesia, and the House of Representatives) and BPRs should proceed in cooperating on a mutually beneficial basis and move forward to a market based policy in anticipation of globalization as stated in WTO.

Location is an important element of public policy and BPR strategy. The location-dependent minimum paid up capital requirements, business site expansions, operational scopes/coverage (regional zones): administrative vs. geographic coverage can be unresolved issues in the future. Further dialogue between policymakers and BPRs should continue to find a solution. The dialogue can also cover some elements of location such as distance (radius), geographic proximity, transaction costs, overlapping areas, spatial competition (enlarge or reduce geographic coverage): incumbent and rival (competing) banks; big nodes, small nodes, hub-functions (independent channel representatives): expansion strategies.

Future research

The results suggest that exploring some aspects of a bank client relationship in more detail would be worthwhile. Further research about the complexity and dynamics of the bank and client relationship can also give a clearer picture to understand the occurrences of the puzzles (e.g. low impact of organizational learning on relationship marketing; relationship marketing on bank performance). Although the directors all have strategic intent – that is to maintain long-term relationships with high-grade clients, in fact it is not easy to implement in daily business operations. Therefore, further research has to incorporate this complexity by adding or modifying some measurable variables in the model. It also gives new insight to organizational learning for BPRs. Given a limited time to codify and share information, directors have alternative choices to accommodate the absorption of underutilized mounting tacit information in the minds of loan officers.

Given that a relationship represents social capital as a resource that people can use to achieve a sustainable positive performance and since there are some puzzles in the models, it is not necessary to discard the last modified model, but rather it is suggested to add some mediating factors, so that one can get a clearer picture about how to improve performance. Future research undertakings may incorporate more appropriate measurable variables by considering this complexity of a relationship that were overlooked in the hypothesized models of this study. Additional factors, such as geographical proximity, the hub role of an AO, and possibly some cultural elements can be included in future studies. The role of an AO as the hub between clients and directors can fit in the framework of a value chain, which is a linkage between internal (relationship) marketing and external (relationship) marketing, and principal-agency relationships as well.

As mentioned above, performance is a simple word; and when this word becomes a concept, an almost unlimited number of potential indicators can be derived from it. The directors have their own perceptions about how to measure their BPRs' performance. They have about 12 performance indicator categories that they believe should be measured. This perception gives a clear picture that there is no single common way to measure BPR performance that is agreed upon by directors and researchers. This is one possible research agenda to determine a more proper way to measure the variety of BPRs.